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CORRESPONDENCE MEMORANDUM

DATE: April 7, 2005
TO: Wisconsin Deferred Compensation Board
FROM: Shelly Schueller, Director
Wisconsin Deferred Compensation Program
SUBJECT: 2004 Annual Investment Performance Report

A copy of the **2004 Annual Investment Performance Report** is presented to you for your review and comment. This report will be discussed at the Board meeting on May 10, 2005. This memo summarizes the findings of the 2004 report and outlines areas for further review and action, including benchmark recommendations for the EuroPacific Growth Fund and additional benchmarks for Fidelity Contrafund.

2004 Changes to the WDC Investment Spectrum

Following the 2003 Wisconsin Deferred Compensation (WDC) investment review, the following changes were made to the WDC investment spectrum:

- The Small Cap Equity Index Fund (Barclays Global Investors) was opened to participants on March 1, 2004.
- The Janus Fund was closed to new deferrals effective June 1, 2004 and will be phased out of the WDC investment spectrum at the end of 2005.
- The Dreyfus Premier Third Century Fund (Class R) was closed out and accounts remaining in the fund were swept to the Vanguard Money Market fund on December 31, 2004.
- The T. Rowe Price International Stock Fund was closed to deferrals effective February 1, 2005 and will be phased out of the WDC investment spectrum at the end of 2005. The EuroPacific Growth Fund (Class R5), offered by American Funds, was opened to participants on February 1, 2005.

WDC Fund Performance

Although several funds experienced negative earnings for the year, the report demonstrates that overall, the majority of the WDC's investment options met or exceeded established performance benchmarks. The funds included in this cover memo failed to meet one or more performance benchmarks.

- *EAFE Equity Index Fund* - Even after allowing for the fund's expenses of 0.10%, this fund under performed its benchmark for the three and five year periods. According to the attached report, the under performance is most likely the result of tracking errors from the futures contracts in which the fund invests, client flows, management fees and the fund's exposure to fluctuations in currency.

Reviewed and approved by David A. Stella, Deputy Secretary.

Signature

Date

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- *T. Rowe Price International Stock Fund* - The performance of the T. Rowe Price International Stock Fund failed to meet its performance benchmarks for the one and three year periods, while its five year return exceeded at least one of the three benchmarks. This fund will be removed from the WDC investment spectrum at the end of 2005.
- *The Janus Fund* - The Janus Fund failed to exceed any of its benchmarks in 2004. It was in the bottom quartile of its peer group and exceeded only the Lipper Large Cap Growth Funds Average for the three-year period. The fund failed to exceed any benchmark for the five-year period. The fund was closed to participants on June 1, 2004 and will be removed from the WDC investment spectrum at the end of 2005.
- *Calvert Social Investment Fund – Equity Portfolio (Class I)* - This fund was added to the WDC in April of 2003 to replace the Dreyfus Third Century Fund as the WDC's socially responsible investment fund option. Continuing a trend from 2003, the fund trailed its peers during 2004, where performance fell within the bottom quartile of large cap blend funds. Two years of under performance may lead to poor three-year comparisons in 2005. According to the attached report, under performance during 2004 is most likely a result of overweighting in Cisco Systems, one of the fund's largest holdings. Even with the under performance of the past two years, this fund meets or exceeds all performance benchmarks for the three and five year periods.

Benchmarks

The Investment Committee and staff recommend that the Board approve the suggested benchmarks for the EuroPacific Growth Fund and the addition of two more benchmarks for Fidelity Contrafund.

- The recommended benchmarks for the American Funds EuroPacific Growth Fund (Class R5) are the MSCI EAFE Index (which is used by the fund to benchmark) and the Morningstar Foreign Large Cap Blend category average. EuroPacific Growth was added to the WDC and opened to participants on February 1, 2005. Note: The EuroPacific Growth fund is classified as a foreign large blend fund by Morningstar and replaces the T. Rowe Price International Stock as the WDC's international fund offering.
- Will Danoff, the fund manager for Fidelity Contrafund, repositions Contrafund from growth to value to blend, depending on his view of the stock market. Because of this regular repositioning, the Investment Committee and staff concur that the benchmarks for Contrafund should be updated to include both the Morningstar Large Growth category average and the Morningstar Large Value category average. These benchmarks would be used in addition to the benchmarks already in use by the Board, which are the Morningstar Large Blend category average and the Russell 3000 Index, and should provide an accurate benchmark for Contrafund regardless of the direction (value, growth or blend) of the fund.

Conclusion

The WDC Program continues to experience growth as a result of both new deferrals and investment income, with approximately 42,000 participants holding assets at the end of 2004 exceeding \$1.55 billion. In comparison, in 2003 there were 40,593 participants in the WDC holding just over \$1.34 billion in the WDC.

Staff will be available at the meeting to discuss the report and answer any questions you may have regarding the WDC's investment options.

Attachment